(27)

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENT, DIRECTOR, DIVISION OF TAXATION, SUBMITTED ON BEHALF OF CHEVRON CORPORATION

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PRELIMINARY STATEMENT

Pursuant to Rule 37.3 of the Rules of this Court, this amicus curiae brief in support of Respondent is filed with the written consents of the parties, on file with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

In this Court's order of March 11, 1992, the views of amici curiae were invited with respect to three questions raised by the Court.

1. Should this Court overrule *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F. W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

The issues presented are of great importance to Chevron Corporation ("Chevron") and many similarly situated companies. Chevron is an integrated petroleum company, domiciled in California, with operations in each of the fifty states and in more than 100 foreign countries. Chevron conducts its worldwide petroleum business directly, through its domestic and foreign subsidiaries and affiliates, and through partnerships and other joint ventures.[1]

Chevron and its subsidiaries have long received foreign source dividends from foreign affiliates, which are

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[1] Subsidiaries refer to corporations in which Chevron, directly or indirectly, holds more than a 50 percent stock interest. Affiliates refer to corporations in which Chevron, directly or indirectly, holds a 50 percent or less stock interest.

engaged in various aspects of Chevron's unitary petroleum business.[2] Two of these affiliates, Arabian American Oil Company ("Aramco") and P.T. Caltex Pacific Indonesia ("CPI") were engaged in crude oil production in Saudi Arabia and Indonesia, respectively, and constituted major sources of crude oil supplies for Chevron's unitary business. In addition, dividends from these affiliates comprised a major portion of Chevron's worldwide net income. The treatment under the California Bank and Corporation Tax Law (Cal.Rev. & Tax. Code § 23001, et seq.) of the dividends received in 1967 from Aramco and CPI was the subject of a decision rendered by the California State Board of Equalization in which the dividends were held to be apportionable business income under California's version of the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985) ("UDITPA"). See *Appeal of Standard Oil Company of California*, CCH Calif.Tax Rptr. ¶ 400-383 (1983).

Chevron is presently involved in a litigation in the Superior Court of the State of California for the tax years 1974-1979, which presents questions regarding the proper California tax treatment of the foreign source dividends received by Chevron from Aramco and CPI, both in terms of the apportionable income base and the apportionment formula.

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[2] Because of the absence of a controlling ownership interest, none of the affiliates are included in a combined report for state tax reporting purposes. While intercompany dividends from combined subsidiaries are eliminated, dividends from affiliates are not.

Chevron believes that this Court's decisions in *ASARCO* and *Woolworth* have created confusion in the field of state taxation of income from intangibles – a field in which Chevron has a major interest. This Court should revisit its opinions in *ASARCO* and *Woolworth*. Particularly, it should clarify the distinction between a unitary business relationship for combined reporting purposes and a unitary business connection for purposes of determining whether income is apportionable or not.

SUMMARY OF ARGUMENT

Chevron shares the views of the parties and various amici that *ASARCO* and *Woolworth* need, at a minimum, to be clarified. The cases should not be read to require a unitary business relationship in the combined reporting sense between a dividend payor and payee before a dividend is deemed to be apportionable business income. Majority ownership and control of a dividend payor is not a necessary prerequisite for apportionment. A unitary business relationship can exist between a corporation and its affiliates notwithstanding the absence of management control. For example, where a corporation holds a substantial minority interest in another corporation to obtain a source of supply for its unitary business, there is a functional integration between the entities. Because it assures a source of supply, the minority interest in the affiliate should be viewed as an integral part of the parent's unitary business and dividends paid by the affiliate should be classified as apportionable business income.

Further, the principles that apply in determining the scope of a unitary business, whether conducted by one corporation or by several affiliated corporations, are not the same as those that determine whether a particular item of income received by that business, such as dividends or capital gains, is subject to apportionment. There is no dispute that under certain circumstances, apportionable business income may also be found where there is no unitary relationship between the underlying businesses of the payor and payee of dividends. The classic example is short term working capital investments. A particular item of intangible income should be apportionable if the investment from which it is derived is held as an integral part of the unitary business of the taxpayer, conducted in part in the taxing state.

The rules for determining whether income received is apportionable business or nonapportionable nonbusiness income set forth in UDITPA and the Multistate Tax Commission regulations, including the presumption in favor of an apportionable business income classification, are reasonable and consistent with the Due Process Clause. The cause for uniformity in state income taxation would be well served if this Court were to validate the general approach taken by UDITPA and refrain from adopting an unduly restrictive set of principles that favor the arbitrary attribution of income from intangibles on a commercial domicile or other situs basis.

The unitary enterprise should be treated consistently whether it is conducted through divisions of a single corporation or through subsidiaries and affiliates of a multicorporate group. Where dividends from a subsidiary or affiliate are found to be apportionable business

income because there is a unitary relationship between the underlying businesses of the payor and payee, there should be a correlative adjustment made to the payee's apportionment formula to take into account an appropriate percentage of the factors of the payor which generated the earnings from which the dividends were paid.

ARGUMENT

I. INTRODUCTION

ASARCO and *Woolworth* do not need to be overruled. However, they do need to be clarified. In these decisions, this Court has injected great uncertainty and confusion into state income taxation of multistate and multinational businesses by appearing to endorse at least two novel concepts regarding application of the unitary business principle.

First, the opinions in these cases can be read to require a multistate corporate taxpayer to own and exercise a controlling position in another company in order for dividends or gains derived therefrom to be apportionable. In this respect, this Court has confused the determination of the scope of the unitary business in a multicorporate combined report setting with the determination whether particular items of income received by the unitary business once its scope has been defined, are properly apportioned among the states in which that business is conducted. As this Court recognized in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 430, n.5 (1980), majority ownership and control

of a payor corporation is not determinative of the latter issue.

Second, *ASARCO* and *Woolworth* have also created confusion because they can be read to require functional integration between the underlying businesses of the payor and payee of dividends before apportionment of the income is permitted. Clearly where functional integration between the operations of affiliated corporations *is* present, as it was in *Mobil*, then apportionment of the intangible income derived by the taxpayer from its interest in the affiliate is appropriate and consistent with the requirements of due process. However, such "functional integration" between affiliated corporations has never been the exclusive basis on which intangible income could be apportioned. So long as the stockholdings from which the income is derived are an integral part of the business operations of the taxpayer conducted in part within the taxing state, the "minimal connection" and "rational relationship" required by due process are present.

ASARCO and *Woolworth* also addressed a third, and conceptually distinct, point by holding that intangible income could not be held to be part of the apportionable income of the taxpayer derived from its business conducted within the taxing jurisdiction merely because it contributed to the "riches" of the corporation and thus provided a source of funds for the conduct of that business. *ASARCO, supra,* 458 U.S. at 326; *F.W. Woolworth Co., supra,* 458 U.S. 354, 363. This Court can correct the two areas of confusion previously discussed without also rejecting the view that the mere generation of wealth by an investment, without any closer relationship between

the investment and the operations of the unitary business of the taxpayer within the taxing state, cannot support apportionment. The widely accepted provisions of UDITPA, which focus on the integral relationship of the shareholdings in question to the conduct of the business of the taxpayer within the taxing jurisdiction, provide a reasonable and constitutional stopping point short of the unprecedented restrictions of "managment control" and "functional integration" suggested by the majority in *ASARCO*. As the dissent in *ASARCO* correctly recognized, "without a well-founded constitutional mandate, [the Court] has straitjacketed the States' ability to develop fair systems of apportionment, prematurely ending the evolutionary process begun by the Uniform Division of Income for Tax Purposes Act and the Multistate Tax Commission." *ASARCO, supra,* 458 U.S. at 349.

II. MANAGEMENT CONTROL IS NOT AN ESSENTIAL ELEMENT IN DETERMINING WHETHER THE BUSINESS OF A DIVIDEND PAYOR IS SUFFICIENTLY INTEGRATED WITH THAT OF THE PAYEE TO ALLOW APPORTIONMENT OF THE DIVIDENDS.

In the state corporate income tax field, there are two distinct but related areas of controversy which frequently arise involving the application of the unitary business principle.

The first concerns whether various divisions of a single corporate entity or of a commonly controlled group of corporations are engaged in a single unitary business, or in two or more separate unitary businesses,

each with its separate apportionment factors and net income determination. *Butler Bros. v. McColgan*, 315 U.S. 501 (1942) and *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980) are cases which involved the two or more business issue in the context of a single corporation. In this situation, ownership and control are necessarily present.

Although not an issue in the single corporation context, more than 50 percent ownership and control is required by the states that use combined reports to determine the apportionable income of a multicorporate unitary business group. That is because common ownership and control is a necessary corollary to treating separately incorporated entities as if they were fully owned divisions of a single corporation. The combined report methodology was upheld by this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). Under this methodology, all income and factors of a commonly controlled and sufficiently integrated multicorporate group are combined in a single report in order to arrive at the income attributable to the activities conducted in the taxing state.

The second area of controversy involving the application of the unitary business principle is not concerned with determining which divisions and/or controlled entities are part of the unitary business. Rather, it arises after the scope of the unitary business group has been determined and involves a separate question. That question is whether particular items of income, such as dividends, interest, rents, royalties and capital gains, are subject to apportionment because they arise from property interrelated with or constituting an integral part of the conduct

of the taxpayer's unitary business, or whether they are subject to specific allocation on a situs or other basis because they arise from property dissociated from the unitary business. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont, supra,* 445 U.S. 425 was the first decision of this Court to address the question of apportionment versus specific allocation of income from intangibles in the context of state income taxes. *Mobil* established that more than 50 percent ownership and control is not a necessary prerequisite for dividend apportionability. *Mobil* involved both subsidiary "(more than 50% owned)" (Id. at 428, n.1) and non-subsidiary (affiliated) corporations of which "it owned, directly or indirectly, 5% or more of the capital stock." Ibid. In fact, a major portion of the dividends at issue in *Mobil* came from Aramco "of which appellant (Mobil) owned 10% of the capital stock." Id. at 430, n.5. In upholding the apportionment of dividends from affiliates, which formed part of a functionally integrated enterprise with the payee, where the ownership interest was *significantly* less than 50%, this Court clearly proceeded on the assumption that majority ownership and control are not constitutionally required.[3]

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[3] It is important to note that in *Mobil* this Court did not reach the issue whether foreign source dividends are properly subject to tax by *any* state. See *Mobil, supra,* 445 U.S. 425, 446 ("[A]ppellant eschews the broad proposition that foreign source dividends are immune from state taxation"). See also *Container, supra,* 463 U.S. 159, 169, n.7. Chevron does not concede the propriety of any such state taxation. Under the Foreign Commerce Clause there are significant issues whether this can give rise to unconstitutional multiple taxation of the dividend income. The discussion herein assumes, for purposes of argument, that there is no constitutional prohibition to the taxation of the dividend income.

This Court's decisions in *ASARCO* and *Woolworth* should not be read otherwise. However, those decisions contain language which, if read out of context, could be argued to support the view that the criterion of "management control" used for determining whether a subsidiary should be included in a combined report group, should also be used as the basis for permitting apportionment of intangible income.[4] See *ASARCO*, 458 U.S. at 321-322, 323-324. In the final analysis, however, the opinions are unclear as to the type of "unitary business *relationship*" (*ASARCO, supra*, 458 U.S. 307, 325) or "functional integration" (*Woolworth, supra*, 458 U.S. 354, 364) between the activities of the dividend payor and those of the payee, that may be constitutionally required.[5] In fact, its

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[4] Notably, both *ASARCO* and *Woolworth* involved foreign subsidiaries where combined reports could have been required and where sizable amounts of stock related income was included with no reflection of the underlying apportionment factors of the subsidiary giving rise to the intangible income. Whether the cases would have been decided differently if the state apportionment formulas there involved had given some recognition to the underlying factors of the dividend paying subsidiaries and affiliates is difficult to determine.

[5] It is noteworthy that in *ASARCO*, this Court did not reject out of hand the notion that dividends from ASARCO's minority interests in General Cable, Revere Copper and Mexicana were subject to apportionment. Similarly, ASARCO's lack of voting control in 51% owned Southern Peru Copper was only one of the factors leading to this Court's conclusion that ASARCO and Southern Peru Copper were not integrated or interdependent. While there were significant intercompany sales by Southern Peru Copper to ASARCO for the years in question, "[t]here was evidence that ASARCO could replace this output contract '[w]ithin a short time' if it were lost, and that loss of ASARCO's ownership in Southern Peru would not cause the loss of the output contract" (*ASARCO, supra*, 458 U.S. 307, 321, n.17).

decisions appeared to be based on a detailed review of the record and uncontroverted findings of fact by the trial court.[6] *ASARCO* and *Woolworth* can be reconciled with *Mobil* and *Butler Bros.* on the ground that majority ownership and control may be important in some instances to assist in establishing integration at the managerial level when other equally important factors relevant to establishing functional integration between the dividend payor and payee are not present.

The rule of law which should be clearly reaffirmed in the present case, is that there is *no* requirement that dividends be received from a "unitary subsidiary" in the sense of combined reporting control and ownership requirements in order to classify dividends as apportionable business income. Rather, it is sufficient that the dividend paying subsidiaries and affiliates contribute in some meaningful way to the payee's unitary business and thus function as part of the payee's unitary business. For purposes of determining apportionable business income the Constitution requires nothing more.[7]

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[6] For example, this Court noted in *ASARCO* that the dissent's characterization of the companies involved as "captive suppliers and customers" was "at odds with the undisputed facts" (Id. at 325, n.21).

[7] However, there remains the issue whether adjustments to the apportionment formula are required. See Argument V, infra.

III. APPORTIONABLE BUSINESS INCOME MAY ALSO EXIST IN CERTAIN CIRCUMSTANCES WHERE THERE IS NO UNITARY RELATIONSHIP IN ANY SENSE BETWEEN THE UNDERLYING BUSINESSES OF THE PAYOR AND PAYEE OF DIVIDENDS.

It is agreed by the parties and various amici that there are a number of situations where income from intangibles is apportionable even though there is an absence of a unitary relationship, in any sense, between the businesses of the payor and payee. The example used by all is income from short term investments for the purpose of providing working capital. Another example is the temporary investment in stock of entities listed on national stock exchanges of funds set aside for such things as workers' compensation claims, rain and storm damage and machinery replacement.

The necessary connection of a particular item of income with the unitary business of the taxpayer can be established in other ways as well. Even longer term investments in functionally unrelated businesses may bear an integral relationship to the business of the taxpayer conducted within the taxing jurisdiction. As the dissenting opinion in *ASARCO* correctly recognized, "the interim investment of retained earnings prior to their commitment to a major corporate project . . . merely recapitulates on a grander scale the short-term investment of working capital prior to its commitment to the daily financial needs of the company." *ASARCO, supra,* 458 U.S. 307, 338 (O'Connor, J., dissenting). In determining whether income is part of the unitary business of the taxpayer or is nonbusiness income, it is essential to define

the transactions and activities which are the elements of the taxpayer's trade or business. This is the approach taken under UDITPA.

Under UDITPA, all income is classified as either business or nonbusiness. UDITPA "distinguishes between the 'business income' of a multi-jurisdictional enterprise which is apportioned by formula and its 'nonbusiness income' which is not." *Container Corporation of America v. Franchise Tax Board, supra,* 463 U.S. 159, 167. UDITPA defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." UDITPA § 1(a). "Nonbusiness income" is defined as "all income other than business income." UDITPA § 1(e).[8]

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[8] The Multistate Tax Commission's regulations which interpret UDITPA set forth a "presumption" in favor of business income and provide that "the income of a taxpayer is business income unless clearly classifiable as nonbusiness income." MTC Reg. § IV.1.(a). The regulations make the characterization of income as apportionable business income as opposed to allocable nonbusiness income turn largely on the "business purpose" for which the intangibles are acquired or held. See MTC Reg. §§ IV.1.(c)(3)-(5). This analysis is closely tied to the due process requirement of showing sufficient contribution to the business conducted in the taxing state. This is not an unworkable subjective standard. As used in the regulations "business purpose" is simply a shorthand reference to the existence of underlying objective facts demonstrating a close or integral relationship between the business of the taxpayer and the income producing property.

The UDITPA approach to the definition of business income is reasonable and quite workable. If the relationship between the underlying businesses of the payor and payee is *not* a unitary one, the inquiry should not end there. The question remains whether the property giving rise to the income is held as an integral part of the taxpayer's unitary business. If so, any income generated in the form of dividends (or capital gains upon sale) should be treated as apportionable business income. If not, the income should be considered nonbusiness. Indeed, while this Court in *ASARCO* took exception to the "corporate purpose" standard utilized in UDITPA as applied in that case by Idaho to ASARCO's long term investments, it is evident that this Court did not question the appropriateness of dividend apportionment in all circumstances in which a unitary relationship between the underlying businesses of the dividend payor and payee was absent. See *ASARCO, supra,* 458 U.S. 307, 325, n.21. See also id., at 337-8 (O'Connor, J., dissenting). This Court should clearly set forth its approval of dividend apportionment in those cases where stock is held for a purpose directly related to the operations of the taxpayer's unitary business enterprise.[9]

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[9] It should be made clear that adoption of the UDITPA approach does not necessarily mean that all income will be considered business income subject to apportionment. Even under the Multistate Tax Commission's regulations, which contain a presumption in favor of business income, there are examples of transactions and activities which generate nonbusiness income. See MTC Reg. §§ IV.1.(c) (1) Examples (iv), (v), (vii); (2) Example (v); (3) Example (vi); (4) Example (vi); (5) Example (iii).

The UDITPA rules for determining whether income is business or nonbusiness (and the Multistate Tax Commission regulations interpreting UDITPA) are a reasonable attempt at a difficult task. Their adoption by a majority of the states is a good indication of their viability. An opinion by this Court which indicates the general acceptability of UDITPA's approach would go a long way to promoting uniformity and the avoidance of multiple taxation in this area – a development which is sorely needed.

IV. A PRESUMPTION IN FAVOR OF APPORTIONMENT AVOIDS THE APPLICATION OF ARBITRARY SITUS RULES AND PROMOTES UNIFORMITY.

Absent the adoption of uniform apportionment and allocation rules, there exists a potential for duplicative taxation of a multistate corporate taxpayer, particularly on income from such items as capital gains, dividends, interest and royalties, where, regardless of the relationship of the income to the taxpayer's multistate business operations, the state of legal domicile or commercial domicile or some other state asserts full taxing jurisdiction on the basis of a fictional "situs" of the corporation.[10] Similarly, there exits a potential for avoidance of taxation where such business-related income items are not taxed

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[10] See Dexter, Taxation of Income from Intangibles of Multistate-Multinational Corporations, 29 Vanderbilt L.Rev. (1976) 401, 402-403, stating that a legal basis for taxing the same intangible income may exist in five different jurisdictions giving rise theoretically to quintuple taxation if each state were to press its jurisdictional claims to the fullest extent.

because a state is persuaded that legitimate tax jurisdiction lies elsewhere. The application of UDITPA's uniform apportionment and allocation rules to all items of income, regardless of labels, avoids the problem of duplicative taxation and at the same time assures that foreign corporations engaged in unitary business operations within a UDITPA state pay their fair share of tax on capital gains and losses, dividends, interest, royalties and the like which arise out of or are related to such operations.

UDITPA's presumption in favor of business income avoids the application of an arbitrary commercial domicile rule in situations where either the taxpayer or taxing authority is unable to demonstrate by clear and cogent evidence that the income was unrelated to the unitary business enterprise. It is noteworthy that this Court has expressed strong reservations concerning the view that dividend income should be specifically allocated to the state of commercial domicile of the payee. See *Mobil, supra,* 445 U.S. 425, 444-446. Even in *ASARCO* and *Woolworth,* there was no indication that this Court concluded the dividend income involved was wholly taxable by the respective commercial domicile states.

There is "nothing talismanic" about the concept of commercial domicile in the area of corporate taxation of income from intangibles. *Mobil, supra,* 445 U.S. 425, 445. As a matter of due process, the state in which a multistate or multinational corporation maintains its commercial domicile has no greater claim for taxing dividends than any other state in which the payee is present. See ASARCO, *supra,* 458 U.S. 307, 346-7 (O'Connor, J., dissenting).

It is difficult to see why taxation of the entire intangible income of a corporation by the state of corporate domicile, regardless of any relationship of such income to the business activities of the corporation conducted within that state, can be said to be more rational from a due process standpoint than the full apportionment of such otherwise unattributable intangible income to all of the states in which the corporation conducts its business.[11]

The "commercial domicile" rule for assigning a taxable situs to intangibles rests on the ancient doctrine of *mobilia sequuntur personam*, which is a legal fiction bearing no relationship to either the economic realities underlying the generation of the income of a multistate or multinational business enterprise, nor the underlying due process requirement of rationality. See *Mobil*, 445 U.S. 425, 445-446 (" '[T]he reason for a single place of taxation no longer obtains' when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction"). Because the fiction unjustifiably favors the domiciliary state at the expense of other states in which the corporation conducts its business, the Court would be fully justified in concluding that

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[11] As the dissenting Justices correctly pointed out in *ASARCO*:

> "Surely it is highly anomalous that the Due Process Clause should require the dividend income of a far-flung interstate business selectively to be attributed solely to the State or two in which a few minimal securities management functions are carried out, rather than apportioned among all the States whose 'civilized society' has made the income-generating wealth of the larger enterprise possible." (*ASARCO, supra*, 458 U.S. 307, 348.)

nothing in the Due Process Clause prevents full apportionment of all intangible income, absent a clear showing that the income producing property was held in the course of activities having nothing to do with the conduct of a taxpayer's multistate unitary business operations. Such a conclusion would be consistent with the presumption expressed in the regulations of the Multistate Tax Commission that all income is apportionable business income unless "clearly classifiable" otherwise.[12]

V. WHERE DIVIDENDS ARE FOUND TO BE APPORTIONABLE BUSINESS INCOME DUE TO THE UNITARY RELATIONSHIP BETWEEN THE PAYOR AND PAYEE, THE PAYEE'S APPORTIONMENT FORMULA SHOULD BE ADJUSTED TO TAKE THE PAYOR'S FACTORS INTO ACCOUNT.

While the issue of apportionment formula adjustments apparently is not being pursued by Petitioner herein and was not reached by this Court in *Mobil*,[13] *ASARCO* or *Woolworth*, it should be a necessary element in this Court's consideration of the constitutional principles applicable to state taxation of intangible income of multistate and multinational corporations. It is an issue in states which require combined reports and in those which do not. It has spawned considerable litigation in the state courts and will continue to do so.[14] Where stock giving

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[12] See footnote 8, *supra*, at p. 14.

[13] This issue was considered by Justice Stevens in his dissent.

[14] See for example *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me., 1991); *American Telephone & Telegraph Co. v. Wisconsin Department of Revenue*, 422 N.W.3d 629 (Wisc., 1988); *NCR Corporation v. South Carolina Tax Commission*, 402 S.E.2d 666 (S.C., 1991).

rise to apportionable dividends or gains is held for a purpose directly related to the taxpayer's unitary business operations, but there is no operational integration between the dividend payor and dividend payee, no formula adjustment may be required.[15] However, in the case of functionally integrated subsidiaries and affiliates, the adjustment of the payee's apportionment formula to take into account the factors of a dividend payor is necessary to assure that the unitary enterprise is treated in a consistent manner.

In such a situation, "the dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise." *Mobil, supra,* 445 U.S. 425, 440. There is no change in the underlying economic realities of the unitary business, whether the income is generated by a division or is repatriated as dividends from a separate legal entity. Accordingly, in either case, the tax treatment should be the same. In the former situation, the division's property, payroll and sales factors utilized in generating the income are includable in the apportionment formula in order to determine the proper amount of income attributable to the taxpayer's activities in the taxing state. The same analysis should also obtain in the latter situation. Otherwise, as Justice Stevens stated in *Mobil*:

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[15] This of course would not preclude a taxpayer from demonstrating in the appropriate case that some type of formula adjustment is necessary in order to assure that the income apportioned to the taxing state is rationally related to values connected with the taxing state. See UDITPA § 18; MTC Reg. § IV. 18.

"Unless the sales, payroll and property values connected with the production of income by the payor corporations are added to denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base *will inevitably cause Mobil's Vermont income to be overstated.*" Id. at 461. (Emphasis added.)

Under this Court's external consistency standard, factors used in the apportionment formula must actually reflect a reasonable sense of how the taxpayer's income is generated.[16] There is a symmetrical relationship between the income base and the factors. If the symmetry is absent in a particular case, unconstitutional extraterritorial taxation can occur. For example, where foreign source income is included in the apportionable income base, but none of the foreign factors which generated that income are included in the apportionment formula, the formula will inevitably attribute too much income to the taxing state and too little to the foreign jurisdictions. See *American Telephone & Telegraph Co. v. Wisconsin Department of Revenue, supra,* 422 N.W.2d 629, 636; *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271 (1924). See also Rudolph, State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups, 25 Tax L. Rev. 171, 205 (1970).[17]

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[16] *Container Corporation of America v. Franchise Tax Board, supra,* 463 U.S. 159, 169.

[17] As indicated by Justice Stevens and Justice O'Connor in their respective dissents in *Mobil* and *ASARCO,* such a violation of the Due Process Clause could also be a violation of the Commerce Clause:

(Continued on following page)

The inclusion of large sums of intangible income, such as dividends, in the apportionable income base, without any inclusion in the apportionment formula of the factors of the payor which generated the earnings from which the dividends were paid, raises serious questions whether the apportionment formula is fair. Where the dividend income is includable due to the functional integration existing between the payor and payee, consistent application of the unitary business principle requires that the formula be adjusted to take into account this unitary relationship.

CONCLUSION

ASARCO and *Woolworth* do not need to be overruled. Rather, the decisions can be reconciled with *Mobil, Butler Bros.* and *Container* if one concludes that majority ownership and control are not necessary criteria for apportioning dividends. This Court should clarify that *ASARCO* and *Woolworth* set forth a non-exclusive manner in which

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"[I]f in a particular case, use of an allocation formula has the effect of taxing income earned by an interstate entity outside the State, it could alternatively be said to have the effect of taxing the income earned by that entity inside the State at a rate higher than that used for a comparable, wholly intrastate business, a discrimination that violates the Commerce Clause." *Mobil, supra*, 445 U.S. 425, 452, n.4 (Stevens, J., dissenting); *ASARCO, supra*, 458 U.S. 307, 350, n.14 (O'Connor, J., dissenting).

to establish the apportionability of income and that functional integration between affiliated corporations has never been the sole basis on which intangible income could be apportioned. Apportionment is also proper where the stockholdings from which the income is derived are demonstrated to be an integral part of the business operations of the taxpayer conducted in the taxing state. This Court should validate the general approach to apportionment taken under UDITPA, but avoid the application of arbitrary situs rules. Finally, this Court should consider the significant issues raised concerning the fairness of the apportionment formula where substantial sums of intangible income are includable in a state's apportionable income base.

Dated: April 9, 1992

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